IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

Nos. 60, *et al.*

FEDERAL POWER COMMISSION, ET AL., *Petitioner*,

v.

SUNRAY DX OIL COMPANY, *Respondent*.

No. 111

SHELL OIL COMPANY, *Petitioner*,

v.

PUBLIC SERVICE COMMISSION OF NEW YORK, *Respondent*.

No. 143

SKELLY OIL COMPANY, HUMBLE OIL & REFINING COMPANY, MRS. JAMES R. DOUGHERTY, ET AL., W. A. STOCKARD, ET AL., EDWIN M. JONES OIL COMPANY, *Petitioners*,

v.

PUBLIC SERVICE COMMISSION OF NEW YORK AND LONG ISLAND LIGHTING COMPANY, *Respondents*.

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR SHELL OIL COMPANY, SKELLY OIL COMPANY, HUMBLE OIL & REFINING COMPANY, MRS. JAMES R. DOUGHERTY, ET AL., W. A. STOCKARD, ET AL., AND EDWIN M. JONES OIL COMPANY

(See page 2 of Cover for Counsel)

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OPINIONS BELOW

The opinion of the Court of Appeals to which this brief is directed is reported at 373 F.2d 816. The court opinion is based upon two different administra-

tive records which resulted in two different opinions of the Federal Power Commission (herein referred to as Commission), known as the *Hawkins* case and the *Sinclair* case.[1] The opinion and order of the Commission in the *Hawkins* case, involving sales in Texas Railroad Commission District No. 3 (III R. 7292-7317), are reported at 34 FPC 897 (1965); its opinion and order on rehearing in *Hawkins* (III R. 7505-7508) is reported at 34 FPC 1330 (1965). The opinion and order in the *Sinclair* case, involving sales in Texas Railroad Commission District No. 2 (IV R. 4172-4193), are reported at 34 FPC 930 (1965); the opinion on rehearing in *Sinclair* (IV R. 4283-4287) is reported at 34 FPC 1357 (1965).

JURISDICTION

The judgment of the Court of Appeals reversing and remanding to the Commission for further proceedings was entered on February 7, 1967. The petitions for writ of certiorari were timely filed and the jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

STATUTE INVOLVED

The Federal Power Commission's authority to issue certificates of public convenience and necessity is prescribed in Section 7(c) and 7(e) of the Natural Gas Act, 52 Stat. 821, 825, 15 U.S.C. 717f(c), (e), the pertinent parts of which are reproduced in Appendix B attached hereto.

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[1] See Appendix A for a narration of the manner in which these proceedings arose and how they relate to the consolidated proceedings arising out of the Court of Appeals for the Tenth Circuit.

QUESTIONS PRESENTED

1. Whether. in determining the level of the "in-line" price at which a certificate will issue, the Commission has the power to consider *inter alia,* "current conditions" in the industry, which include contract prices, temporary certificates, intrastate market competition, and the effect of its own policies on those conditions, or whether the Commission is limited to a consideration solely of selected prices which have not been opposed by any party and hence, having been permanently certificated, are no longer subject to review?

To restate the question in more basic terms, having once determined the price "line" in a given area, is the Commission divested of jurisdiction to change that "line" in a certificate proceeding because of unilateral action of intervenors in opposing all prices above their own preselected price level?

2. Did the Commission abuse its discretion in holding that questions of pipeline and public need for gas may be determined in pipeline certificate proceedings instead of in producer certificate proceedings?

STATEMENT OF THE CASE

The decision of the court below involves review of two proceedings before the Commission which, in turn, involved approximately seventy-five producer applications for certificates of public convenience and necessity. In one of the consolidated proceedings, the *Hawkins* case,[2] relating to sales in Texas Railroad Commission District No. 3, the Commission authorized ap-

[2] H. L. Hawkins & H. L. Hawkins, Jr., Operator, *et al.*, Opinion No. 475, issued September 22, 1965, (III R. 7288-7316). The case takes its name from the designation of the lead docket in the consolidated proceedings before the Commission.

proximately three dozen producer sales conditioned to in-line prices of 16.0 cents prior to September 28, 1960, and 17.0 cents per Mcf after September 28, 1960. In the other proceedings, the *Sinclair* case,[3] relating to sales in Texas Railroad Commission District No. 2, the Commission authorized approximately forty producer sales conditioned to in-line prices of 15.0 cents prior to September 28, 1960, and 16.0 cents per Mcf after September 28, 1960. Only the in-line prices for the period after September 28, 1960, were remanded by the Court of Appeals and only these prices are here on review.[4]

In each of the consolidated proceedings the Commission based its determination of the in-line prices upon its analysis of current conditions in the area during the periods when the contracts in question were executed. Its determinations in these cases, together with its opinions in other in-line price cases issued at about the same time,[5] constitute the culmination of the Commission's in-line price technique utilized to fix the levels at which producers' gas may enter the interstate market. In order to place the Commission's in-line price

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[3] Sinclair Oil & Gas Co., *et al.*, Opinion No. 476, issued September 22, 1965 (IV R. 4168-4193). Like the *Hawkins* case, this case takes its name from the company whose docket leads the list in the consolidated proceedings at the Commission level.

[4] The Court of Appeals for the District of Columbia Circuit is referred to herein as "Court of Appeals."

[5] The Commission's Opinion No. 422 in Amerada Petroleum Corp. (I R. 5768-5804) was reviewed by the Court of Appeals for the Tenth Circuit and is consolidated herewith in Case Nos. 60, 61, and 62. Other proceedings, involving sales in the South Louisiana Area, have been the subject of review proceedings in Pan American Petroleum Corp. v. F.P.C., 376 F.2d 161 (10th Cir. 1967), petitions for certiorari pending in Case Nos. 227, 415, 516, and in Continental Oil Co. v. F.P.C., 378 F.2d 510 (5th Cir. 1967), petitions for certiorari pending in Case Nos. 504, 520, 526, and 628.

method in proper context, it is appropriate to trace the history of development of the in-line price cases from its inception with the CATCO case.

In the wake of this Court's CATCO[6] decision, the Commission embarked on a new type of regulation under Section 7 of the Natural Gas Act.[7] The first step in this new method was issuance of the Statement of General Policy No. 61-1.[8] Drawing on its expertise, the Commission divided the gas producing areas of the United States into pricing areas announcing "guideline prices" in each area. For each of the "pricing areas"[9] in the Texas Gulf Coast, the guideline price was set at 18 cents per Mcf, although the Commission had previously permanently certificated sales at prices as high as 20 cents per Mcf[10] in Texas Railroad District No. 3.

The Commission then attacked its large "backlog" of certificate applications by announcing that all pending certificate applications, and all applications filed thereafter, would be approved at uncontested hearings,

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[6] Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 (1959).

[7] Prior to CATCO, the Commission considered producer certificate applications on an individual basis, or consolidated groups of producer applications with the pipeline application for a certficate for the facilities required to connect the new supplies furnished by the producers.

[8] 24 FPC 818: This Court commented on the Commission's new approach to certificate cases in *Second Phillips*, Wisconsin v. F.P.C., 373 U.S. 294, 307, 308 (1963).

[9] The Commission conformed its pricing areas in the Texas Gulf Coast to the Districts delineated by the Texas Railroad Commission as District Nos. 2, 3, and 4. Cases Nos. 60, 61, 62, 80, and 97 involved Railroad District No. 4, and Cases Nos. 111, 143, 144, and 231 involve Railroad Districts 2 and 3.

[10] Trunkline Gas Co., 21 FPC 704 (1959).

would unduly lengthen the proceedings. It was sustained in this discretionary decision first by the D.C. Circuit in *Public Service Commission of New York* v. *F.P.C.*[21] and later by this Court in *United Gas Improvement Co.* v. *Callery Properties, Inc.* (*Callery*).[22] Until the issue of the Commission's discretion to decline to consider such evidence was resolved, however, the producers continued to tender such evidence. Such evidence was tendered in this case (in both the *Sinclair* and *Hawkins* cases), but was denied admission by the Examiners and this denial was affirmed by the Commission (III R. 7299; IV R. 4183-4).

On the same day that the Commission issued its *Skelly* decision, the Commission amended the Statement of General Policy reducing the guideline price in Texas Railroad Commission District No. 4 from 18 cents per Mcf to 16 cent per Mcf.[23] In *Texaco Seaboard*,[24] the Commission determined the in-line price for Texas Railroad Commission District No. 3 to be 16 cents prior to September 28, 1960, and concurrently therewith reduced its guideline price in District No. 3 from 18 cents to 17 cents. No appeal was taken from

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[21] 329 F.2d 242 (D.C. Cir. 1964); *cert.* denied, 377 U.S. 963 (1964).

[22] 382 U.S. 223 (1965).

[23] 28 FPC 441; the court below appears to have been under the erroneous impression that the Commission first determined the in-line price and then fixed the guideline price above it. See IV R. 4309. In fact, the reverse situation occurred. The Commission determined the guideline price first and then fixed the in-line price *below* it. In fact, it should be recalled that at the time when Post-Policy Statement contracts involved here were entered into and temporary certificates were issued *there was no in-line price*. It was after this period that the Commission retrospectively fixed in-line prices of 15 cents per Mcf (District 2) and 16 cents (District 3) for pre-Policy Statement sales.

[24] 29 FPC 593 (1963).

this Commission order. In *Hassie Hunt Trust,*[25] the Commission determined the in-line price prior to September 28, 1960, to be 15 cents for Texas Railroad Commission District No. 2, and concurrently reduced its Statement of General Policy guideline price for this area from 18 cents to 16 cents.[26] *In each of these cases the Commission expressly found that the record was not adequate to determine the in-line price for the period after September 28, 1960, and deferred this decision to another proceeding to specifically deal with this issue.*[27]

The proceedings dealing expressly with determination of the in-line price subsequent to September 28, 1960, are the three Commission cases here under review, designated by their lead dockets in the Commission as *Amerada*[28] (Railroad District No. 4), *Hawkins*[29] (Railroad District No. 3), and *Sinclair*[29] (Railroad District No. 2). *Hawkins* and *Sinclair* included some dockets involving sales prior to September 28, 1960, which had been involved in a prior appeal[30]

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[25] 30 FPC 1438 (1963).

[26] 30 FPC 1435 (1963).

[27] *Skelly,* 28 FPC 412 (1962); *Texaco Seaboard,* 29 FPC 599 (1963); *Hassie Hunt Trust,* 30 FPC 1442-44 (1963).

[28] Affirmed, Sunray DX Oil Company v. F.P.C., 370 F.2d 181 (10th Cir. 1966), Case Nos. 60, *et al.* A fourth case, also dealing with Railroad District No. 4, entitled *Turnbull & Zoch,* in the Commission, was affirmed by the Fifth Circuit in Continental Oil Co. v. F.P.C., 378 F.2d 510 (5th Cir. 1967), applications for certiorari pending. Case Nos. 504, 520, 526, and 628.

[29] Consolidated in the D.C. Circuit and reversed, Public Service Commission of New York v. F.P.C., 373 F.2d 816 (D.C. Cir. 1967), Case No. 111, *et al.*

[30] Public Service Commission of New York v. F.P.C., 295 F.2d 140 (D.C. Cir. 1961), *cert.* denied, *sub. nom.* Shell Oil Company v. Public Service Commission of New York, 368 U.S. 948 (1961).

provided the sales were at prices equal to or less than the announced guideline prices, and provided further that there were no interventions filed. If an opposing party intervened, no certificate would be issued except after a contested hearing, even though the price for which approval was sought was equal to or less than the guideline level. Certain distributor companies[11] and the Public Service Commission of New York adopted the practice of intervening in substantially all producer certificate dockets involving proposed sales in the Texas Gulf Coast Area where the initial price provided in the contract exceeded a level of 14-15 cents per Mcf.[12]

Because of the policy followed by the intervenors,[13] contested hearings were necessary, resulting in the ac-

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[11] The Brooklyn Union Gas Company, Long Island Lighting Company, and the Philadelphia Gas Works Division of the United Gas Improvement Company, petitioners in Cases Nos. 62 and 97, and respondents in Cases Nos. 111, 143, and 144, were among the more active intervenors.

[12] See, Public Service Commission of New York v. F.P.C., 329 F.2d 242, 250, note 8 (D.C. Cir. 1964).

[13] We will refer to The Brooklyn Union Gas Company, Long Island Lighting Company, and Philadelphia Gas Works Division of the United Gas Improvement Company, and the Public Service Commission of New York collectively as "Intervenors" because these parties appeared in that capacity in the proceedings before the Commission. Under Commission regulations, the Public Service Commission of New York can intervene as a matter of right in any Commission case, Public Service Commission of New York v. F.P.C., 295 F.2d 140 (D.C. Cir. 1961), *cert.* den. *sub. nom.*, Shell Oil Co. v. Public Service Commission of New York, 368 U.S. 948 (1961). As a matter of policy the Commission has uniformly granted the intervention of the distribution companies when requested to do so even though the granting of such interventions required the holding of a contested hearing on a rate which would otherwise have been approved under the Commission's shortened procedure provided by its Rules for uncontested cases.

cumulation of a large number of pending producer applications. While in most of the other pricing areas of the United States[14] the Commission was able to consolidate all pending certificate applications in an area into one proceeding, no less than seven contested hearings were required to determine the in-line price in the three Texas Railroad Commmission Districts making up the Texas Gulf Coast Area,[15] because of inter-

[14] The only other pricing area requiring extensive litigation was the Southern Louisiana Area, in which the same intervenors were heavily involved.

[15] The certificate cases determining the in-line prices in the pricing areas in the Texas Gulf Coast, each involving many consolidated dockets, are listed as follows:

1. Skelly Oil Co., 28 FPC 401 (1962); affirmed, *sub. nom.*, Public Service Commission of New York v. F.P.C., 329 F.2d 242 (D.C. Cir. 1964); *cert.* den. *sub. nom.*, Prado Oil & Gas Corp. v. F.P.C., 377 U.S 963 (1964).
2. Texaco Seaboard Inc., 29 FPC 593 (1963).
3. Amerada Petroleum Corp., 31 FPC 623 (1964); affirmed on the in-line issue, Sunray DX Oil Co. v. F.P.C., 370 F.2d 181 (10th Cir. 1966); certiorari granted and consolidated with instant case (I R. 6782-6786), Cases Nos. 60, 61, 62, 80 and 97.
4. Hassie Hunt Trust, Operator, 30 FPC 1438 (1963); affirmed Continental Oil Co. v. F.P.C., 378 F.2d 510 (5th Cir. 1967).
5. H. L. Hawkins and H. L. Hawkins, Jr., 34 FPC 897 (1965); reversed Public Service Commission of New York v. F.P.C., 373 F.2d 816 (D.C. Cir. 1967)—certiorari granted, Cases Nos. 111, 143, 144 and 231 (IV R. 4326-29).
6. Sinclair Oil & Gas Co., 34 FPC 930 (1965); consolidated with the *Hawkins* case on review in the District of Columbia Circuit, reversed, Public Service Commission of New York v. F.P.C., 373 F.2d 816, the cases here on certiorari, *supra*.
7. Turnbull & Zoch Drilling Co., 34 FPC 1001 (1965), consolidated with the Hassie Hunt case on review in the Fifth Circuit, affirmed, Continental Oil Company v. F.P.C., 378 F.2d 510 (5th Cir. 1967) petitions for certiorari pending in Cases Nos. 504, 520, 526 and 628.

venors' policy of intervening in cases involving prices which were at or below guideline levels.

The Commission grouped the producer certificate applications in two ways, first, according to the pricing area (*e.g.*, Texas Railroad Commission District) in which the sale took place, and second, according to the date the contract of sale was entered into. Sales to different pipelines were grouped together indiscriminately. The related pipeline certificate applications for the necessary facilities were considered in separate proceedings in which the pipelines' supplies and markets (the pipelines' "need" for the gas) were issues, and without exception, and in most instances without contest, the pipeline certificates were granted.[16]

Because of the long procedural delays involved in obtaining permanent certificates in contested proceedings (*e.g.*, two Shell dockets in this case have been pending before the Commission or the Courts since 1959), and because in some instances drainage was caused by other wells in the same fields already certificated by the Commission, and because the producers were required to pay "shut-in" royalties and suffer a delay in the return of their investments, the producers were compelled by economic necessity to apply for and accept "temporary authorizations" to commence deliveries while the certificate applications were pending. Although no formal hearing was required to obtain these temporary authorizations,[17] the Commission

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[16] One pipeline certificate application, involving Lone Star Gas Company was later withdrawn, but the sale of gas continued to other markets. See, "Order Vacating Certificates and Permitting Abandonment," issued September 15, 1967, Lone Star Gas Co., *et al.*, Docket Nos. CP 65-118, *et al.*

[17] Public Service Commission of New York v. F.P.C., 327 F.2d 893 (D.C. Cir. 1964).

utilized its authority to "hold the price line" even here, by customarily imposing one or more of three types of conditions: (1) a price condition reducing the price to the Commission's guideline price,[18] (2) a further price condition imposing an express refund obligation down to a specified level, at or below the guideline price level, and (3) a condition which precluded the producer from filing a rate increase under Section 4 of the Natural Gas Act.[19] The Commission's power to impose these conditions in a temporary certificate has been sustained by this Court in *F.P.C.* v. *Hunt,* 376 U.S. 515 (1964).

In its *Skelly* decision issued August 30, 1962,[20] the Commission determined the in-line price in Texas Railroad Commission District No. 4 for the period *prior to September 28, 1960,* the date of the Statement of General Policy No. 61-1, to be 15 cents per Mcf. The Commission specifically reserved decision on what the in-line price was in that pricing area after that date, stating it would convene a separate hearing on that issue, 28 FPC 412. In the *Skelly* decision the Commission also determined, for the first time, that it would not consider cost and economic evidence supporting the producers' contract prices in a certificate case under Section 7 of the Natural Gas Act, finding that to do so

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[18] The "guideline price" refers to the price level fixed by the Commission in the Statement of General Policy No. 61-1, as changed by various amendments. The "in-line" price refers to the price determined for a pricing area by the Commission in a contested certificate proceeding under Section 7 of the Act.

[19] Various dockets consolidated in these cases show examples of these types of conditions, imposed by the Commission in the temporary certificates issued—see III R. 1414-20; III R. 7302-4; IV R. 709-14; IV R. 4189-92.

[20] Skelly Oil Co., 28 FPC 401.

in which the Commission was held to have erred in excluding the Public Service Commission of New York as an intervenor.

Having decided to follow its *Skelly* rule and exclude all cost and economic evidence tendered by the producers in these cases, the Commission then proceeded to consider the evidence which remained. The Commission gave primary weight to permanently certificated sales, but realized that if it looked only to these sales it would be excluding from consideration the vast majority of the sales of gas in interstate commerce from the area. In *Amerada*, the Commission found that to look only to permanently certificated sales would be to base the in-line price on only *1.39 per cent* of the volumes being sold, which was less than the volumes sold under only two dockets in the case being considered (IR. 5784). In Texas Railroad District No. 4, the Commission (I R. 5786) found that 82 per cent of the gas presently moving in interstate commerce was at 16 cents or above. The weighted average price was 16.5 cents with contract prices ranging up to 20.045 cents per Mcf (I R. 5786). The Commission selected as the "in-line" price the "lowest price at which substantial volumes of new gas were sold in interstate commerce in the period in question" (I R. 5789). The Commission further stated that "While there is evidence that points in the direction of a higher price, we believe the teachings of CATCO require that we draw the line at the *lowest reasonable level.*"[31] (I R. 578). Finally, the Commission concluded:

> "Our decision herein draws the line substantially below the average going price for gas in the area

[31] Emphasis supplied throughout unless otherwise indicated.

and in fact, two cents per Mcf below the Commission's guideline ceiling price prevailing at the time these contracts were executed. The 16-cent determination herein thus not only preserves, but actually rolls back, the initially considered price line for the period in issue." (I R. 5790).

In the *Hawkins* case in District 3, the Commission reaffirmed on this record its holding in *Texaco Seaboard*[32] and *Hassie Hunt*[33] that the in-line price for the pre-Policy Statement period was 16 cents per Mcf (III R. 7296). The Commission then considered the permanently certificated prices arrayed by Staff and producer witnesses for the post-Policy Statement period, noting that 42.6 per cent of the volumes of gas being sold under permanent certificates were at a price of 18 cents per Mcf (III R. 7295). Here again, the volumes of gas being sold under temporary certificates in the contested proceedings required by the interventions vastly exceeded the volumes for which permanent certificates had issued (all in uncontested proceedings). The Commission therefore gave "some weight" to contract prices and temporarily certificated prices, because it found, as in *Amerada,* that to fail to consider these prices would result in a "freeze of the price line" because of the obivous fact that many of the prices above the arbitrarily determined "acceptable level" of the intervenors were contested and therefore fell into the "temporarily certificated" category (III R. 7296). In addition to the contract and certificate prices, the Commission also considered evidence of the impact of its guideline price on subsequent negotiations between

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[32] 29 FPC 593 (1963). No appeal filed.

[33] 30 FPC 1438 (1963), affirmed, Continental Oil Co. v. F.P.C., 378 F.2d 510 (5th Cir. 1967).

producer and pipeline, which showed that the producers had voluntarily reduced their prices in many instances to conform to the Commission's guideline prices (III R. 226; 333).

A similar pattern to that discussed above in Districts 4 and 3 was disclosed by the record in *Sinclair* for Texas Railroad Commission District 2. The Commission reaffirmed its determination of the pre-Policy Statement line in *Hassie Hunt* at 15 cents per Mcf and that decision was not disturbed by the court below. As to the period following the issuance of the Policy Statement the Commission determined the price line to be 16 cents per Mcf, relying on evidence similar to that considered in *Hawkins* and *Amerada.* Specifically, the Examiner found that 83.36 per cent of the gas moving in interstate commerce from District 2 under contracts executed after the Policy Statement was priced at 16 cents per Mcf or more (IV R. 3918). By including contracts below 14 cents in the tabulation, the Commission found that even then 53 per cent of the volumes were being sold at prices above 16 cents per Mcf (II R. 4181). Here again the volumes sold under temporary certificates exceeded those under permanent certificates, and the Commission found that to limit the price consideration only to those certificates which the intervenors had permitted to become permanent without contest would create a prize freeze and render the hearing in this proceeding meaningless (IV R. 4180). As the Commission noted:

> "The pre-policy price would automatically control because almost all contracts above 15.0 cents were contested." (IV R. 4180)

In each of the three decisions the Commission made mention of the fact that the uncontested sales, which

constituted the bulk of the permanent certificates, were issued for "isolated" sales of small volumes which were remote from the pipelines and, therefore, could not command the going market prices. It found that to base the price line on such sales would be to ignore the direction of this Court in *Callery*—and of the various Circuit Courts[34] that the line must be based on sales of ***substantial*** volumes in interstate commerce under ***contemporaneous*** conditions.

The Intervenors had also argued to the Commission in *Hawkins* and *Sinclair* that the producer sales should not be certificated because of allegedly adverse take-or-pay positions of the pipeline purchasers.[35] But they offered no evidence to support their contentions, or to show how general allegations could be specifically related to the instant sales. In contrast, the evidence adduced by producer-applicants does show the take-or-pay status of the several pipeline purchasers (III R.

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[34] United Gas Improvement Co. v. F.P.C., 283 F.2d 817 (9th Cir. 1960); Atlantic Refining Co. v. F.P.C., 316 F.2d 677 (D.C. Cir. 1963); Sohio Petroleum Co. v. F.P.C., 298 F.2d 465 (10th Cir. 1961); California Oil Co., Western Div. v. F.P.C., 315 F.2d 652 (10th Cir. 1963); Public Service Commission of New York v. F.P.C., 329 F.2d 242 (D.C. Cir. 1964); California v. F.P.C., 353 F.2d 16 (9th Cir. 1965)

[35] A common provision in gas sales contracts between producers and pipelines is the "take-or-pay" provision pursuant to which, over a specified period of time—usually one year, the purchaser is required to take an average quantity of gas or pay for it A make-up period is also provided which permits the pipeline to take additional quantities of gas in later periods to make up the earlier underproduction. When a pipeline, for a variety of reasons, makes prepayments for gas not yet taken, it may be said that it is in an adverse take-or-pay position. Significantly, however, the prepayment for gas does not mean that the pipeline forfeits the gas. There is no indication in these proceedings that any pipeline has not been able to schedule make-up gas at later dates.

1336-1339). Some of the pipelines, namely, Natural Gas Pipeline Company of America and Trunkline Gas Company, did not have any prepayments (III R. 1338). Others had made relatively minor prepayments, which the producer witness testified without contradiction, could be traceable to contracts in South Louisiana which are not involved here (III R. 1333-1339, 1337).

Based upon this record and its own expert knowledge of how pipeline companies must schedule their purchases, the Commission concluded the issue of need could properly be confined to pipeline certificate proceedings (III R. 7293). However, in the exercise of its judgment, the Commission did attach to each certificate a condition making the take-or-pay provision in the gas sales contract subject to a pending rule-making proceeding in Docket No. R-199. Subsequently, when the Commission later issued its Order No. 334, in Docket No. R-199, which extended the make-up periods under all certificates to a minimum of five years, its action applied to these sales.

Petitions for review of the Commission's decision in *Amerada* were filed in the Tenth Circuit Court of Appeals, and of the Commission's *Hawkins* and *Sinclair* decisions in the District of Columbia Circuit Court of Appeals, resulting in conflicting decisions by the Circuit Courts below.[36] This Court granted certiorari and consolidated these cases for briefing and argument (I R. 6782-6; IV R. 4326-9).

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[36] Contemporaneous appeals of the Commission's Turnbull & Zoch Drilling Co., Opinion No. 478, 34 FPC 1001 (1965), and *Hassie Hunt* decision were filed in the Fifth Circuit Court of Appeals resulting in affirmance of the Commission on this issue by the Fifth Circuit in Continental Oil Co. v. F.P.C., 378 F.2d 510 (5th Cir. 1967).

STATEMENT OF POSITION

Petitioners joining in this brief were parties to the *Hawkins* and *Sinclair* cases before the Commission, and intervenor-respondents in support of the Commission in review of these cases by the District of Columbia Circuit.[37] These Petitioners support the validity of the Commission-determined in-line prices and the Commission determination to consider questions of pipeline and public "need" for the gas in a pipeline certificate proceeding rather than a producer certificate proceeding,[38] believing both decisions of the Commission to be based on substantial evidence and within the discretion granted to the Commission under the Natural Gas Act, as explained by prior decisions of this Court. In the *Hawkins* and *Sinclair* cases, the Court of Appeals did not reach the issue of the existence or extent of the power of the Commission to require refunds, as prior to its decision no refunds had been ordered.[39] Since that issue is not present here, it is not covered by this brief.

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[37] One of the petitioners was also a party to the *Amerada* case before the Commission (Humble Oil & Refining Company), while others (Shell Oil Company, Skelly Oil Company, and Mrs. James R. Dougherty, *et al.*) were not. Because of the difference in the records in the Commission and the courts below, separate briefs are being filed by the parties to the Tenth Circuit and D.C. Circuit cases.

[38] The latter question was not raised in the Petition for Certiorari filed by Shell Oil Company, Case No. 111. To the extent permitted by the Court's Rules, Shell joins in the argument set out herein on the "need" issue.

[39] Except where the temporary certificates issued by the Commission expressly authorized refunds (III R. 7302-4; IV R. 4190-91).

SUMMARY OF ARGUMENT

In CATCO,[40] this Court announced the rule that the Commission could not issue a certificate without substantial evidence supporting the price level for the sale of gas by an independent producer to an interstate pipeline company. In *Callery*,[41] this Court sustained the Commission in the procedure which it had adopted after CATCO to determine the price level in the various gas producing areas of the United States. In this case this Court is asked to determine whether any party, through selective interventions in producer certificate cases before the Commission, can "freeze" or reduce the price "line," even though in the exercise of its discretionary power to consider current conditions the Commission finds, upon the basis of substantial evidence, that the price line has changed from that existing in an earlier time period. We believe that inherent in the Commission's power to determine the price line, is the power to determine that the line has changed and the Commission did not abuse its discretion in considering evidence leading to that result.

Further, the Court of Appeals improperly substituted its judgment for the expert administrative judgment of the Commission to determine where issues of pipeline and public need should be decided. On the narrow take-or-pay issue raised by the Intervenors, the Commission was amply justified, both by its expert knowledge of the nature of the gas business and by substantial record evidence, in protecting the public interest through attaching appropriate conditions to

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[40] Atlantic Refining Company v. Public Service Commission of New York, 360 U.S. 378 (1959).

[41] United Gas Improvement Co. v. Callery Properties, Inc., 382 U.S. 223 (1965).

the producer certificates, subjecting the certificates to rule-making proceedings in Docket No. R-199.

Moreover, the lower court's *sua sponte* suggestion that the Commission should determine the relative superiority of the end-use for gas before authorizing a producer sale to pipeline fails to recognize the nature of the gas business and is inconsistent with this Court's decision in *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366 (1965) and should be reversed. *F.P.C.* v. *Colorado Interstate Gas Co.*, 348 U.S. 492, 498-499 (1955).

ARGUMENT

I. THE EFFECT OF THE DECISION BELOW IS TO "FREEZE" THE PRICE LINE AFTER IT HAS ONCE BEEN DETERMINED BY THE COMMISSION, OR TO "ROLL IT BACK" TO THE PRICE LINE EXISTING IN AN EARLIER PERIOD.

A. The Cumulative Effect of the Intervenors' Actions of a Procedural Nature

If the decision of the court below is sustained, it will mean that merely by the act of intervention, intervenors and others so disposed, will be able to freeze or "rollback" the price line in the Texas Gulf Coast Area to levels in existence ten years or more ago, despite increases in costs, changes in market conditions, in trends in gas exploration and in reserve additions, in contract prices and other relevant developments; also despite actions of the Commission to stabilize prices in this area pending its determination of a just and reasonable rate in the Texas Gulf Coast Area Rate Proceeding, now awaiting decision by the Commission's Examiner. The Intervenors have proceeded in the following manner:

1. The Intervenors determined that a price of 14-15 cents was "acceptable" to them. No plausible rea-

son has ever been given, either in evidence, filed in a Commission proceeding or in any brief filed with the appellate courts, for the selection of this level.

2. These interventions were filed in substantially all cases involving sales of gas from the Texas Gulf Coast Area which exceeded their pre-selected level of 14-15 cents, whether or not the gas sold was serving consumers in the area in which Intervenors were interested. Initially, the Commission denied some of these petitions to intervene and notices of intervention on the grounds that the intervenors had no standing to represent consumers in other parts of the United States.[42] The New York Commission appealed the ruling of the Commission, and the District of Columbia Circuit reversed, holding that the New York Commission had the absolute right under the Commission's Rules to intervene in all producer certificate cases in the Texas Gulf Coast Area, regardless of whether the gas was serving New York markets.[43] This Court denied *certiorari*.[44] Thereafter, the Commission granted all petitions to intervene and notices of intervention filed by Intervenors.

3. After the issuance of the Statement of General Policy No. 61-1 by the Commission providing for a guideline price of 18 cents for the entire Texas Gulf Coast Area in September, 1960, the Intervenors continued to intervene in subtsantially all

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[42] Note this Court's language in *Second Phillips,* Wisconsin v. F.P.C., 373 U.S. 294, 305 (1963).

[43] Public Service Commission of New York v. F.P.C., 295 F.2d 140 (D.C. Cir. 1961).

[44] Shell Oil Co. v. Public Service Commission of New York, 368 U.S. 948 (1961).

producer certificate cases in that Area under Section 7 of the Natural Gas Act where the initial contract price exceeded their arbitrary level of 14-15 cents. Under the procedure adopted by the Commission, these interventions compelled a contested hearing, even though the contract price was equal to, or less than, the guideline price. The Commission consolidated large numbers of these producer certificate cases into joint proceedings, requiring at least two years to complete at the Commission level, and 5-7 years when court review is added.[45]

During this period there were a number of sales, usually involving small volumes at remote distances from the pipeline connections, where the producer was unable to sell his gas for more than the 14-15 cent level selected by Intervenors.[46] As these sales were at or below the Intervenors "acceptable level," no interventions were filed. Under Commission practice, permanent certificates were issued for these sales in uncontested procedings, usually within 90 days after the application was filed.

4. Intervenors sought to exclude all cost and economic evidence which the producers attempted to introduce to show that their contract prices were "in the public convenience and necessity" on the grounds

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[45] The *Amerada* case was convened by Commission order issued August 30, 1962, the *Sinclair* case on March 25, 1964, and the *Hawkins* case on March 30, 1964. Both *Sinclair* and *Hawkins* included some producer dockets involved in the earlier Commission "Coastal" proceeding in which the Commission's order granting certificates was set aside for failure to permit the New York Commission to intervene, see Public Service Commission of New York v. F.P.C., 295 F.2d 140, *supra*, p. 20.

[46] The Commission discussed the nature of these unrepresentative sales at page 16 of its *Amerada* decision (I R. 5787).

that consideration of this evidence would unduly delay the determination of the price "line" and the issuance of permanent certificates. In the *Skelly* decision[47] the Commission adopted the Intervenors' position, and after extensive litigation the discretionary power of the Commission to exclude cost and economic evidence in a certificate proceeding was sustained by this Court in *Callery.* Prior to this Court's decision in *Callery,* the producers continued to tender such cost and economic evidence as offers of proof which the Commission uniformly rejected. Such evidence was tendered in the *Amerada, Sinclair,* and *Hawkins* cases in the Commission.

B. The Cumulative Effect of the Exclusion of Evidence Advocated By Intervenors

Even more important than the procedural devices engaged in by Intervenors is the cumulative effect of the application of exclusion of evidence rules which the Intervenors seek to apply. In addition to excluding all cost and economic evidence sought to be introduced by the producers, Intervenors now seek to exclude from Commission consideration in its price line determination, all contract prices above their arbitrarily-selected level of 14-15 cents. Various reasons were given for excluding the higher prices from consideration in determining the price line as follows:

Intervenors' Exclusion No. 1

Intervenors allege that contract prices are in themselves entitled to no consideration because they are a "product of the unregulated market place" and until they have been approved by the Commission are en-

[47] 28 FPC 401, *supra,* pp. 9-10.

titled to no weight. Failure of the Commission to follow this exclusion completely (the Commission considered contract prices to show "economic trends in the area,") (III R. 7295; IV R. 4180) was one ground for remand by the Court of Appeals (IV R. 4306).

Intervenors' Exclusion No. 2

Intervenors assert that temporarily certificated prices are entitled to no weight, even though price reducing conditions were imposed, in some instances, refund conditions imposed in other instances, and moratoria against rate increase filings under Section 4 of the Natural Gas Act imposed in other instances, because they were not arrived at after contested proceedings in which Intervenors could participate. Intervenors completely ignore the reason for the existence of temporary certificates. Temporary certificates are applied for by producers, and granted by the Commission, because of emergency conditions, such as drainage of gas, payment of shut-in royalties, possible loss of leases, etc., which require the delivery of gas before the completion of the lengthy contested certificate proceedings.[48]

Intervenors further ignore that but for their own interventions, permanent certificates would have been issued in uncontested proceedings in most instances, making the temporary certificate procedure unnecessary. They also ignore the fact that the price levels fixed in the temporary certificates were arrived at after mature consideration and issuance of the Policy Statement. Failure of the Commission completely to exclude

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[48] The Commission's discretion to issue such temporary certificates was upheld by the D.C. Circuit in Public Service Commission of New York v. F.P.C., 327 F.2d 893 (D.C. Cir. 1964), and this Court in F.P.C. v. Hunt, 376 U.S. 515 (1964).

temporarily authorized prices, although giving them less weight than permanent certificates (III R. 7295-97; IV R. 4179-80) was one ground for remand by the Court of Appeals (IV R. 4307-13).

Intervenors' Exclusion No. 3

Intervenors contend that the Commission cannot consider any prices in other dockets in this certificate proceeding which it has consolidated with a particular producer's docket because all of these prices are being contested in the same proceeding by the Intervenors. In view of the Commission's practice of consolidating all contested certificate proceedings in a given pricing area into one case, this exclusion would effectively eliminate from consideration of the price line any price which Intervenors elect to contest, because these contracts are all consolidated in the same case. Intervenors ignore the fact that the producers have no control whatever over what the Commission consolidates, and have unsuccessfully objected to the consolidation of their dockets with others on the grounds that additional regulatory expenses are imposed upon them by the consolidation.

Intervenors' Exclusion No. 4

Intervenors would preclude consideration of any prices which are being contested by Intervenors at the Court level, in determining the price line, because such prices are "suspect". This reasoning has been sustained by the D.C., Fifth, and Ninth Circuits, and by this Court in *Callery*.

Intervenors' Exclusion No. 5

Under Intervenors' theory, even many permanently certificated prices, which are no longer subject to re-

view, which are above Intervenors' predetermined level, should be excluded for one reason or another. Prices permanently certificated by the Commission in an earlier proceeding[49] (in which Intervenors participated) in this area, because they represented sales to a new pipeline not yet in operation, and therefore may have resulted in higher prices than sales to an established pipeline. This reasoning was accepted by the Commission in *Skelly, supra,* and affirmed by the D.C. Circuit in *Public Service Commission of New York* v. *F.P.C.*[50] It was followed by the Commission in both *Hawkins* (III R. 7299-300) and *Sinclair.*

Intervenors' Exclusion No. 6

Intervenors would exclude other certificated prices on a different theory. Any contract prices, *even permanently certificated prices,* not subject to review, should not be used in determining the price line if they were at the same level as other prices in the same area still being contested by Intervenors *in other cases.* This reasoning was accepted as a part of the "suspect" doctrine by the D. C. Circuit[51] and the Ninth Circuit.[52]

Intervenors' Exclusion No. 7

Still a third class of permanent certificates are sought to be excluded because they were "tainted" by being

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[49] Houston Texas Gas & Oil Corp. and Coastal Transmission Corp., 16 FPC 118, (1956), affirmed, Florida Economic Advisory Council v. F.P.C., 251 F.2d 643 (D.C. Cir. 1958) *cert.* denied, 356 U.S. 959 (1958).

[50] 329 F.2d 242 at p. 246 (D.C. Cir. 1964).

[51] Atlantic Refining Co. v. F.P.C., 316 F.2d 677, 680 (D.C. Cir. 1963).

[52] United Gas Improvement Co. v. F.P.C., 283 F.2d 817, 824-825, (9th Cir. 1960), *cert.* den., *sub. nom.*, Superior Oil Co. v. United Gas Improvement Co., 365 U.S. 879 (1961).

certificated prior to this Court's decision in CATCO and consequently should not be considered by the Commission. This reasoning was rejected by the Ninth Circuit[53] and the Court of Appeals here (IV R. 4315).

Intervenors' Exclusion No. 8

Even after all of the prices listed above are excluded, Intervenors still contend that the highest prices in the area should not be used to represent the line, but rather the weighted average of "non-suspect" prices should be used. This reasoning was accepted by the Commission, and the Commission's discretion sustained by the decision below, the Tenth Circuit's *Sunray* decision consolidated herewith, as well as other Circuit Court cases.[54]

It will be seen from the foregoing discussion that the Intervenors have been almost universally sustained, either by the Commission or the Courts,[55] in their efforts narrowly to limit the evidence which the Commission can consider in exercising its jurisdiction under Section 7 of the Natural Gas Act. It is not the purpose of the Petitioners here to ask the Court to overrule any of the prior decisions limiting the Commission's jurisdiction or sustaining the Commission in its self-imposed limitations of evidence. It is Petitoner's purpose to ask this Court to consider the cumulative effect of these limitations on the evidentiary presentations, and the prices permitted to be consid-

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[53] *Id.*, at pp. 823-824.

[54] Continental Oil Co. v. F.P.C., 378 F.2d 510 (5th Cir. 1967); Pan American Petroleum Corp. v. F.P.C., 376 F.2d 161 (10th Cir. 1967).

[55] Provided that the Court of Appeals decision is not overruled in this case; except for exclusion No. 7, cited above.

ered in establishing the price line. In all three of the cases below, *Amerada, Hawkins,* and *Sinclair,* the Commission clearly recognized that if all of the exclusionary rules urged on them by the Intervenors, were applied, *substantially all of the "contemporaneous" prices which this Court in Callery directed to be considered would be eliminated.*[56] All that would be left to form the price line would be small volume sales at isolated locations sold at lower prices, which Intervenors had elected not to contest. Faced with this alternative, the Commission decided, we think correctly, to give "some" weight to contract prices (III R. 7295; IV R. 4180) and temporarily certificated prices, although giving them "less weight" than permanently certificated prices (III R. 7295-6; IV R. 4181). The Commission's discretion to make this decision, rather than giving strict effect to the rigid exclusionary rules urged by Intervenors, has been sustained by the Tenth,[57] the Fifth,[58] and the Ninth Circuits.[59] The conflicting decision of the D.C. Circuit below, which required rigid application of the exclusionary rules, *even where the result is to exclude substantially all contracts entered into under contemporaneous conditions,* should be reversed by this Court. If it is not, then the Commission's administrative function of determining the public convenience and necessity is reduced to the mere chore of stamping approval on only such applications as Intervenors, and others similarly inclined, so dictate.

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[56] 382 U.S. 223, 227.

[57] Sunray DX Oil Co. v. F.P.C., 370 F.2d 181 (10th Cir. 1966) (I R. 6696-6757) consolidated herewith I R. 6782-6; Pan American Petroleum Corp. v. F.P.C., 376 F.2d 161 (10th Cir. 1967).

[58] Continental Oil Co. v. F.P.C., 378 F.2d 510 (5th Cir. 1967).

[59] California v. F.P.C., 353 F.2d 16 (9th Cir. 1965).

It is apparent from a reading of the decision below that the D.C. Circuit did not appreciate the full effect of its decision on the Commission and the producers subject to regulation. The Court of Appeals said (IV R. 4314):

> "We do not hold that the FPC can never raise the price line on the interim period. We hold only that the Commission had advanced no reason why an escalation is justified in this case."

But if the rigid exclusionary rules of the Court of Appeals are sustained, how can the price line *ever* be changed by the Commisison in a Section 7 case? Under the Court of Appeals decision, contract prices cannot be considered (IV R. 4306). Current conditions cannot be considered unless there "is something special about them" (IV R. 4314).[60] Cost and economic evidence is excluded under *Callery*. The Commission's Statement of General Policy and its stabilizing effect on prices negotiated thereafter cannot be considered (III R. 4307-09). In short, as the Commission pointed out in each of its decisions[61] the strict evidentiary exclusions sought by Intervenors inevitably result in a price "freeze" in all areas of the United States during the interim period before just and reasonable rates are

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[60] The record reflects every conceivable showing of "something special" that can be made by a producer to prove that his contract should be entitled to a price above the in-line price. Examples include: (1) the furnishing of unusual compression and gathering facilities by the producer (III R. 462-63), (2) higher prices under comparable contracts previously permanently certificated by the Commission in the same field (III R. 323-4; 343; 350-51; IV R. 3923-5), (3) higher prices under comparable contracts in the intrastate market (III R. 316-19; IV R. 124-33; 163-65).

[61] *Amerada,* I R. 5785; *Hawkins,* III R. 7296; *Sinclair,* IV R. 4180.

determined. Both the Tenth Circuit[62] and the Fifth Circuit[63] agreed with the Commission that the application of the rigid exclusionary rules sought by the Intervenors would result in a price freeze. Nor do we understand the Court of Appeals to disagree, at least insofar as Section 7 proceedings are concerned (IV R. 4314).

The conclusion of the Tenth Circuit in *Sunray* is set out in the following language (I R. 6722):[64]

> "An in-line price is intended to reflect the price at which substantial volumes of gas are currently contracted for sale in interstate commerce. This determination cannot be made if all current sales are within the 'suspect price' doctrine because of objections made to them. Such an application of the doctrine would, as said by the Commission, make the price determination dependent on the 'unreviewable fiat' of the objectors. Our conclusion is that in the circumstances of this case the Commission did not abuse its discretion by the consideration given to prices not covered by permanent certificates."

The Court of Appeals, however, while pointing out that rates could be changed in proceedings under Section 4 of the Natural Gas Act, either through the collection of a rate increase subject to refund[65] or by the

[62] Sunray DX Oil Co. v. F.P.C., 370 F.2d 181 (10th Cir. 1966), Case Nos. 60, *et al.*, consolidated herewith.

[63] Continental Oil Co. v. F.P.C., 378 F.2d 510 (5th Cir. 1967), application for certiorari pending, Austral Oil Co. v. F.P.C., *et al.*, Case Nos. 504, *et al.*

[64] The Tenth Circuit later reaffirmed its decision in Pan American Petroleum Corp. v. F.P.C., 376 F.2d 161 (10th Cir. 1967), application for certiorari pending; F.P.C. v. Pan American Petroleum Corp., *et al.*, Case Nos. 227, *et al.*

[65] See pp. 38-41, *infra*, where we discuss why the right to file for rate increases under Section 4 does not relieve the producer from the "price freeze" as suggested by the court below.

Commission after an area rate proceeding, conceded that its decision resulted in a price freeze insofar as any proceeding under Section 7 was concerned. The Court said (IV R. 4314):

> "It is true that our decision may cause the in-line price to be frozen temporarily during the interim period between sales of gas and the rate determination under § 4 or § 5 of the Act. This kind of freeze seems to be required by the logic of CATCO and in-line pricing."

In the *Continental* case, the Fifth Circuit had before it the same arguments made by the same parties based on substantially the same type of record. The Fifth Circuit also had before it the Tenth and the District of Columbia Circuit decisions here under review, when it wrote its decision. Recognizing the clear conflict between the two decisions, the Fifth Circuit said (378 F.2d 525-526):

> "We are quite aware that the District of Columbia Circuit, in Public Service Commission of the State of New York v. Federal Power Commission 373 F.2d 816 [Feb. 7, 1967] refused to accept the reasoning of the Tenth Circuit in *Sunray DX*. To the contrary, adopting the Distributors' contention here made the District of Columbia Circuit did freeze the in-line price during the interim period between the sale of gas and the rate determination under § 4 or § 5 of the Act on the logic of *CATCO*. As we stated at the outset, we align ourselves with the Tenth Circuit's *Sunray DX* and the Ninth Circuit's holding that '* * * the "line" referred to in Catco may properly be referenced to relevant existing producer prices under which substantial amounts of natural gas move in interstate commerce * * *' *UGI* v. *Federal Power Commission,* 9 Cir. 1960, 283 F.2d 817."

II. NEITHER THIS COURT'S DECISIONS IN CATCO AND CALLERY, NOR THE CIRCUIT COURT DECISIONS INTERPRETING THEM, REQUIRE A PRICE "FREEZE" UNTIL THE DETERMINATION OF A JUST AND REASONABLE RATE UNDER SECTIONS 4 AND 5.

A. CATCO Does Not Require a Price "Freeze"

The underlying rationale of the decision of the Court of Appeals, as well as the effect of that decision, is that a price "freeze" is "required by the logic of CATCO and in-line pricing." We agree that the rigid exclusionary rules applied by the Court of Appeals would have that result. We deny that such a result is required by the "logic of CATCO." In fact, the "exclusion of all evidence" rules announced by the Court of Appeals are in specific conflict with this Court's CATCO decision. This Court said (360 U.S. 378 at 391):

> "* * * What we do say is that the inordinate delay presently existing in the processing of § 5 proceedings requires a most careful scrutiny and responsible reaction to the initial price proposals of producers under § 7. Their proposals must be supported by evidence showing their necessity to the 'present or future public convenience and necessity' before permanent certificates are issued."

This Court held (360 U.S. at 392):

> "Our examination of the record here indicates that there was insufficient evidence to support a finding of public convenience and necessity prerequisite to the issuance of the permanent certificates."

How can there be sufficient evidence to support a finding of public convenience and necessity if the Commission is required by the Court to exclude all evidence?

How can the Commission give "careful scrutiny" or "responsible reaction" when it is foreclosed from considering any evidence as to price except that which any Intervenor may choose not to contest?

Furthermore, this Court carefully made clear that it was *upholding the Commission's discretion* to impose price conditions, not *directing* the Commission to impose conditions as to price, as the Court of Appeals would do.[66] In the words of the Court, so often quoted (360 U.S. 391):

> "Where the proposed price is not in keeping with the public interest because it is out of line or because its approval might result in a triggering of general price rises or an increase in the applicant's existing rates by reason of 'favored nation' clauses or otherwise, *the Commission in the exercise of its discretion might attach such conditions as it believes necessary.*"

The Commission *did* exercise its discretion here, and *did* attach price conditions which it believed to be necessary in keeping with the public interest. The Commission's decisions are based on substantial evidence.[67] CATCO has been complied with.

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[66] We recognize that the D.C. Circuit decision does not direct the Commission to condition the producers' prices to 15 cents in so many words. But that is the inevitable effect of the decision, as discussed in Section I, *supra*, pp. 19-30.

[67] See Section III, *infra*, pp. 42-53.

B. This Court's Callery Decision Does Not Support the Court of Appeals

Neither the Commission nor this Court in *Callery*[68] was faced with a situation comparable to that reflected on the record in the cases involved here. In *Callery,* the Commission was able to find prices at levels "where substantial amounts of gas have been certificated to enter the market under contemporaneous certificates" without using prices which were "in any way suspect." Therefore, neither the Commission nor the Court was called upon to decide what to do in a situation where the strict application of the "suspect" rule as advocated by Intervenors would result in the exclusion of substantially all of the volumes of gas under "contemporaneous certificates." In the areas involved here, there are no prices approved in a contested hearing under contemporaneous certificates, for the reason that the Commission has consolidated all of these producer certificate applications into the cases here under review.

Under these circumstances, how can the price line be determined? In our view, absent an abuse of discretion, the Court should leave this determination to the Commission, permitting it to consider such evidence of "current conditions," including temporary certificates, contract prices, competing intrastate market evidence, and any other evidence which the Commission deems relevant to determine the "present and future public convenience and necessity" of the prices in question. The suspect price doctrine should not be extended to eliminate all, or substantially all, of the

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[68] United Gas Improvement Co. v. Callery Properties, Inc., 382 U.S. 223 (1965).

evidence which the Commission can consider, resulting in a price "freeze," or a "rollback to prices having no current relevancy." [69]

C. The In-Line Price Must Reflect Current Conditions

All of the cases expounding the in-line pricing theory emphasize the requirement that the price line reflect "current conditions." These decisions clearly require the Commission continually to re-evaluate the conditions in the industry, emphasizing the *time* at which the sale takes place as an important element in determining whether a particular price should be used in determining the price line. This Court's reference to "*contemporaneous* certificates" and "*existing* levels" in *Callery* (382 U.S. at 227) constitutes recognition and approval of the importance of this factor as noted in prior Circuit Court opinions.

In the *UGI* case,[70] the Ninth Circuit rejected a contention by UGI and the New York Commission that the price line must be the same as the pre-CATCO line stating (283 F.2d at 823, 824):

> "As previously indicated, the price line is intended to reflect current conditions in the industry. Therefore, comparative prices upon which it is based must be prices under which a substantial amount of natural gas presently moves in interstate commerce. The limitation urged by UGI could well defeat this objective by restricting the comparison to a small number of contracts under which little gas moves today. It could, in fact,

[69] United Gas Improvement Co. v. F.P.C., 283 F.2d 817, 824 (9th Cir. 1960).

[70] United Gas Improvement Company v. F.P.C., 283 F.2d 817 (9th Cir. 1960).

require a rollback to prices having no current relevancy."

In *Sohio Petroleum Co.* v. *F.P.C.* the Tenth Circuit stated [298 F.2d 465, at 467 (10th Cir., 1961)]:

"* * * the Commission had both the right and duty to re-examine and determine the reasonableness of the in-line price to assure that such price continually served the public interest * * *.

"The purpose of establishing an in line price is of course the stability accorded producer, buyer and the public in balance with the respective interests of each. Permanence is dependent upon the maintenance of such balance and the duty to guard, review, *and, if necessary, change* the in line price, rests with the Commission.

In its prior decisions, the District of Columbia Circuit has also recognized the time factor in determining the in-line price. In *Atlantic Refining Co.* v. *F.P.C.*,[71] the Court stated [316 F.2d 677, at 680 (D.C. Cir. 1963)]:

"As used in CATCO, the line means the price at which similar sales, not suspect, were made under similar circumstances from the same area *about the same time.*"

Also in *Public Service Commission of New York* v. *F.P.C.* the District of Columbia Circuit stated [329 F.2d 242 at 247 (D.C. Cir. 1964)]:

"We think we must honor the discretion thus exercised by the Commission 'to require that the gas

[71] In this case the District of Columbia Circuit affirmed the Commission's decision that the price line in North Louisiana had changed over a 17-month period from 16.5 cents to 17.0 cents as of May 1, 1959, based upon consideration of contract prices and temporarily-certificated prices.

sold be sold under contracts that were *in line as of the time they were executed'*, to adopt its language."

In *Continental Oil Co.* v. *F.P.C.* the Fifth Circuit expressly aligned itself with the holdings of the Ninth Circuit and the Tenth Circuit that the requirement to consider "current conditions" precludes a price "freeze" in a Section 7 proceeding.[72]

D. The Inevitable Result of the Decision Below Is to Deprive Producers of the Hearing Required By Section 7(c) of the Natural Gas Act

If the decision of the Court of Appeals is affirmed, the inevitable result is to reduce the hearing required under Section 7 of the Natural Gas Act to a meaningless formality. As interventions will be filed in all certificate proceedings where the initial price exceeds the previously determined line the price line determination will inevitably be the same.[73] Thus the requirement of the Act for a hearing, and the directions of this Court in *CATCO* and *Hunt* that price be considered in a certificate case will be effectively circumvented. The power to condition the contract prices to a determined "in-line" price necessarily includes the power to change that price as the public interest may require.[74]

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[72] 378 F.2d 510, at 524-525 (5th Cir. 1967).

[73] Conceivably, if the reasoning of the Court of Appeals were adopted, the Intervenors could decide to force the price line down, by intervening in all sales above some lower level.

[74] Sohio Petroleum Co. v. F.P.C., 298 F.2d 465 (10th Cir. 1961).

E. A Price Freeze for the "Interim" Period Before the Establishment of a Just and Reasonable Rate Is Not in the Public Interest

In a certificate proceeding the Commission is empowered to consider all factors which it deems relevant to the present or future public convenience or necessity. Broad though not unfettered discretion is vested in the Commission in this respect, and the courts should not substitute their judgment for that of the Commission, absent a clear abuse of discretion. It is not an abuse of administrative discretion for the Commission to determine, as it has here, that a price freeze is neither required by precedent nor consistent with the public interest. Because of the insistence of Intervenors that a price freeze is required, however, we believe it necessary to point to several facts in the record which support the Commission's decision.

The record reflects that although the price line has been "held" in the Texas Gulf Coast Area, and in fact, has been rolled back from the 20-cent level found necessary in 1959,[75] and the 18-cent guideline level announced by the Commission in 1960, this price "stability" has been accompanied by steadily decreasing volumes of gas sold in interstate commerce since that time (III R. 1491, 1364). The consumer has attained price "stability" at the sacrifice of the incentive required to maintain adequate supplies. It is of little comfort to the consumer that the price is frozen at 15 cents (or

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[75] In Trunkline Gas Co., 21 FPC 704, the Commission found that in 1959 a 20 cent per Mcf price was necessary to bring the gas involved in that case into the interstate market, instead of being sold for intrastate uses and issued a permanent certificate without price conditions.

any other level), if adequate gas supplies cannot be purchased at that price. Because of the long delay attendant to proceedings under Section 4 and 5 to determine a just and reasonable rate,[76] the Commission should and does have discretion to change the price line if changing current conditions require that to maintain adequate supplies, without waiting for the conclusion of a ponderous rate case.[77]

F. Relief From the Price "Freeze" Is Not Afforded by the Right of the Producer To File for a Rate Increase Under Section 4 of the Natural Gas Act

The Court of Appeals was of the view that a price "freeze" would not result under its decision because if the producer was dissatisfied with the in-line price he could file for a rate increase under Section 4 of the Act (IV R. 4314). The Court was in error for the following reasons:

1. The Court of Appeals failed to consider the effective, and for the producer unavoidable, freeze in his price which occurs while the certificate case is pend-

[76] Noted by the Court in *Second Phillips, CATCO, Callery, Hunt* and other cases. In his dissenting opinion in *Sunray,* Judge Seth noted the importance of the in-line determination because of the delays in Section 5 proceedings (I R. 6755-56).

[77] Although all cost and economic evidence was excluded from this record by the Commission under the *Skelly* rule, evidence filed in the Texas Gulf Coast Area Rate Proceeding indicates that "current conditions" have indeed changed and even the in-line rate fixed by the Commission is too low. The cost witness sponsored by the distributor-intervenors (the same parties as Intervenors here, except for the New York Commission) testified in that case that the cost of "new" gas was 16.45 cents per Mcf, and the rate design witness for these same distributors recommends a "new" gas rate of 16.25 cents for Railroad District No. 4, 16.75 cents for Railroad District No. 2 and 17.25 cents for Railroad District No. 3.

ing, either before the Commission, or before the Court of Appeals. During this period, the producer is usually forced by economic pressures to commence delivery of his gas under a temporary certificate issued by the Commission. The Commission customarily imposes a condition that no rate increases under Section 4 can be filed until a permanent certificate is issued. This type of condition was considered by this Court in *Hunt.*[78] The Court considered the conflict between the right of the producer to file for a rate increase under Section 4 and the power of the Commission to impose certificate conditions under Section 7, and held that the Commission had the power to prohibit rate increase filings until the permanent certificate is issued. The Court noted that the delay in obtaining permanent certificates where such conditions were imposed worked against the producer, and that the consumer would be adversely affected by the reluctance of the producer to incur this delay.[79] As any contract price which exceeded the price line would require a contested proceeding before a permanent certificate could issue, the producer's price would be effectively "frozen" by the Commission's practice of imposing in the temporary certificate (1) a price condition reducing the delivered rate down to the in-line price and (2) a prohibition against any rate increase filings while the certificate proceeding was pending.

2. Nor would Section 4 of the Act provide relief from the price "freeze" even after the permanent certificate is issued. After the contested certificate pro-

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[78] 376 U.S. 515 (1964).

[79] *Id.*, at 527.

ceeding is finally completed and a price condition imposed by the Commission reducing the contract price to the in-line price, the producer is first faced with the five-month waiting period prescribed by the Act before the increase can be placed into effect. After this period has expired, there is another obstacle imposed by the Commission. The Commission now imposes a moratorium on rate increase filings above a second arbitrary level, slightly higher than the in-line price, as a condition in the permanent certificate.[80] This Court sustained this moratorium on rate increase filings in *Callery*, as a valid exercise of the Commission's expertise.[81]

Again we emphasize that it is not our purpose here to seek reversal of the power of the Commission to impose conditions in either temporary or permanent certificates which eliminates or reduce the producer's right to file for a rate increase under Section 4, which this Court has sustained in *Hunt* and *Callery*. Rather we are pointing out that the existence of this conditioning power in the Commission, coupled with its active exercise of this power by the Commission in an almost universal fashion, prevents the use of Section 4 to break the price "freeze" in the manner contemplated by the Court of Appeals.

There is yet another reason why the right to file for rate increases under Section 4, to the extent it is not

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[80] The Commission imposes such moratorium as a matter of general practice, as evidenced by the Commission's rulemaking Order No. 296 issued April 5, 1965; 33 FPC 682, 18 CFR 2.56. For Texas Railroad Commission District No. 2 and 4, this level is 18 cents (I R. 5795; IV R. 4191) and for District No. 3 it is 19 cents per Mcf (III R. 7302).

[81] 382 U.S. 223 at 229 (1965).

proscribed by the Commission through certificate conditions, is not a satisfactory solution for the producer. The producer has no way of knowing what part of his rate he will ultimately be entitled to keep when the area rate proceeding is finally completed. This uncertainty interferes with obtaining the necessary finances to continue exploratory operations, subjects the producer to possible overpayments of taxes and royalty obligations, and acts as a strong deterrent against engaging in gas exploration at all.[82] This deterrent effect is making itself felt through declining exploratory activity, with a resultant decline in supply relative to demand. The adverse effect on the consumer of this situation was recognized by this Court in *Hunt*[83] and *Callery*.[84] This factor entered into the Commission's discretionary decision that a higher in-line price in the Texas Gulf Coast Area was required in the 1960's, above that in existence in the 1950's.[85]

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[82] These factors prevent the filing of rate increases from being "the answer" to the price freeze, according to the Fifth Circuit in Continental Oil Co. v. F.P.C., 378 F.2d 510, 525 (5th Cir. 1967).

[83] The price tabulations in the Commission's *Hawkins* opinion (III R. 7294-5) show a decline in permanently certificated first month's volumes in District No. 3 from 2,666,016 Mcf for the 33 month period ending 9/27/60, to 1,128,755 Mcf for the 39 month period ending 12/31/63. See also Charts reproduced as Appendices C and D of this brief (III R. 1491; IV R. 760-61).

[84] 376 U.S. at p. 527.

[85] 382 U.S. at p. 227.

III. THE COMMISSION'S DETERMINATION OF THE PRICE LINE FOR THE PERIOD AFTER SEPTEMBER 28, 1960, IS SUPPORTED BY SUBSTANTIAL EVIDENCE, WAS A PROPER EXERCISE OF COMMISSION DISCRETION AND SHOULD BE SUSTAINED

A. The "Substantial Evidence" Rule Is Applicable to Decisions of the Federal Power Commission

It is a fundamental principle that the decision of the agency must be sustained if the record which formed the basis for its decision contains "substantial evidence" supporting the Commission's decision; *F.P.C.* v. *Hope Natural Gas Co.,* 320 U.S. 591, at 602 (1944); *Illinois Central Railroad Co.* v. *Norfolk and Western Railway Co.,* 385 U.S. 57 (1966); 17 L.ed. 2d 162 at 169; *Western Paper Makers' Chemical Co.* v. *United States,* 271 U.S. 268, at 271 (1926); *Universal Camera Corp.* v. *N.L.R.B.,* 340 U.S. 474 (1951).

Section 19 (b) of the Natural Gas Act (52 Stat. 821, 15 U.S.C. 717(r)(b) provides in part that:

> ". . . The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive."

B. The Commission Has Broad Discretionary Power in Certificate Proceedings Under Section 7.

In CATCO, the genesis of the "in-line" price theory, this Court clearly set out the discretionary power of the Commission to impose price conditions.[86] The discretionary power of the Commission was again emphasized by this Court in *F.P.C.* v. *Hunt* where the Court stated [376 U.S. 515, at 526 (1964)]:

> "*The existence of broad discretionary power* in the Commission to condition temporary certificates appears to us to be vital to its ability to hold the line in pricing."

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[86] See quotation from 360 U.S. at 391, supra, p. 32.

In the *Hunt* case the Supreme Court dealt with temporary certificates. This Court's reliance on Commission expertise in determining the "in-line" price was extended to permanent certificates in *Callery*. The Court stated [382 U.S. 223, at 229 (1965)]:

> "The 'in line' price of 18.5 cents is supported by the contract prices in the south Louisiana area that were not 'suspect,' and the selection of 23.55 cents beyond which a price increase might trigger escalation reflects the Commission's *expertise*." (Emphasis by the Court)

One of the leading certificate decisions following this Court's CATCO decision was written by the Ninth Circuit in *United Gas Improvement Co.* v. *F.P.C.*, 283 F.2d 817 (9th Cir. 1960). In that case the Ninth Circuit reversed the Commission for failure to follow the "logic of CATCO." Recently, the Ninth Circuit had occasion to consider the Commission's approach to certificate cases under the in-line method, in *California* v. *F.P.C.*[87] on an appeal by distributors and the California Public Utilities Commission who had contended that the Commission had based its decision on prices which were "suspect." After a thorough review of all of the in-line cases, the Ninth Circuit stated (353 F.2d at p. 22):

> "Considerable water has gone over the dam since that time, and the Commission is now, as evidenced by the opinions of the Commission in this case, fully aware of the duty that Catco imposes on it to protect the consumer. Its actions in other matters evidence the same awareness. (General Policy Statement No. 61-1, Sec. 2.56, 18 C.F.R. 2.56, amended 26 F.P.C. 661 (1961), 28 F.P.C.

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[87] 353 F.2d 16 (9th Cir. 1965).

441 (1962), 29 F.P.C. 590 (1963), 30 F.P.C. 1435 (1963); FPC Annual Report, 1964, p. 106). [Footnote omitted.] As the Commission states in its brief, after several years of its intensive efforts the national average price for gas levelled off, see FPC Ann. Rep., 1964, at 106, and even appears to have declined, see U.S. Dep't of Labor Wholesale Prices and Price Indexes, B.L.S. Commodity Code No. 0531-01.03, FPC Form No. 2. We think, then, that in view of the many 'in line pricing' cases that the Commission had decided, and of the attitude that it has shown in deciding them, we owe it the same deference to its expertise that courts generally owe to the specialized boards and commissions created by the Congress to deal with complex and difficult problems in the field of economic regulation."

With specific reference to the discretion of the Commission to consider "suspect" prices, the Ninth Circuit said in *California* v. *F.P.C.* [353 F.2d 16, at p. 23 (9th Cir. 1965)]:[88]

> "No doubt there are many certificated prices—some under unconditioned certificates and others (like the Aneth price) conditioned, some established in contested proceedings and others not contested—which might be different, and lower, if the Commission were passing on them under section 7 today. But this, we think, does not *require,* although it may *permit,* the Commission to disregard them or to give little weight to them in deciding what is an appropriate price line to which to refer." (Emphasis by the Court)

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[88] The Ninth Circuit recently reaffirmed its faith in the Commission's expertise in California G[illegible] Producers Association v. F.P.C., Case No. 21310, — F.2d —, decided September 15, 1967, citing the quoted language.

Even the District of Columbia Circuit has, in past cases,[89] emphasized the discretionary power of the Commission.

C. The Record Contains Substantial Evidence Which Supports the Commission's Determination of the In-Line Price

1. The Evidence in the Hawkins Record Sustaining the 17-Cent Price Line for Post-Policy Statement Sales in District No. 3.

a. Evidence of "Current Conditions"

Three producer witnesses testified on the in-line price in Railroad District No. 3. Mr. Robert L. Norris found the in-line price to be 17.5081 cents, based on a weighted average of contract prices of actual volumes of gas delivered in interstate commerce in 1962 (III R. 1569, 698, 6781). Mr. H. L. McDonald testified on behalf of Pan American Petroleum Corporation that the weighted average price received by Pan American in Railroad District No. 3 for all of its intrastate contracts executed since January 1, 1959, was 19.329 cents (III R. 319) and that the interstate price would have to be at least that high to be competitive (III R. 321-327).

Mrs. Celia Gody testified that based on a complete study of contract prices (summarized by a chart at II R. 1500, 1364) the in-line price level would be 18¢

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[89] In Public Service Commission of New York v. F.P.C., 329 F.2d 242, at 247 (D.C. Cir. 1964), the D.C. Circuit said:

> "We think we must honor the discretion thus exercised by the Commission * * *."

In Oklahoma Natural Gas Co. v. F.P.C., 257 F.2d 634, at p. 639 (D.C. Cir. 1958), the D.C. Circuit said:

> "The granting or denial of a certificate of public convenience or necessity is a matter peculiarly within the discretion of the Commission."

per Mcf.[90] Mrs. Gody also showed a sharp decline in gas committed to interstate commerce from Railroad District No. 3, from 33.0 billion cubic feet in 1958 to 2.7 billion cubic feet in 1963,[91] which she attributed to the fact that the "guideline" prices fixed by the Commission were not competitive with the intrastate market in this area (III R. 222-224). All of this evidence supports the Commission's finding that "current conditions" require an in-line price of at least 17¢ per Mcf.

b. Permanently-Certificated Sales

The Staff Economist, Russell T. Jones, prepared exhaustive contract analyses of all contracts in District No. 3 from June 7, 1954 to December 21, 1963 (III R. 1414-1453, 928), using only *permanently* certificated sales (III R. 839-840), expressly excluding temporarily certificated sales and giving no effect to uncertificated contract prices (III R. 839-847; III R. 868-9). A summary chart of Mr. Jones' price exhibit[92] discloses that even under this restrictive consideration, 29.45% of the *permanently certificated* volumes sold in interstate commerce from District No. 3, sold under contracts dated between September 28, 1960, and December 31, 1963, were at a price of 18¢ per Mcf. The Commission placed primary reliance on Mr. Jones' exhibit, but found that he had erred in including sales to Valley Gas Transmission Company at 14¢. The Commission had found in *Amerada* (I R. 5787) and it reiterated in

[90] III R. 234—Gody's Exhibits received in evidence at III R. 1364.

[91] III R. 1491—reproduced as Appendix C of this Brief.

[92] III R. 1453; received in evidence, III R. 928; reproduced as Appendix E to this Brief.

Hawkins (III R. 7294) that because Valley was a gathering company, purchasing gas in small quantities at isolated locations at prices less than the rate acceptable to major interstate pipelines, sales to Valley should not be utilized in determining the price line. On eliminating these sales from Mr. Jones' exhibit, the recomputed table shows that 42.62 per cent of the volumes sold under permanent certificates under contracts dated between September 28, 1960, and December 31, 1963, were at 18 cents.[93] Based on this evidence the Commission concluded (III R. 7297):

> "We are of the opinion that 17.0 cents per Mcf at 14.65 psia is the in-line price for the period following September 28, 1960. It is our judgment that this conclusion gives appropriate weight to the comparatively large volumes sold under permanent certificates at 18.0 cents per Mcf while reflecting the weighted average price of 16.17 cents per Mcf. In addition, a 17.0 cent price clearly gives some weight to the unconditioned contract prices and to the prices under temporary certificates. Finally, some 43 percent of the gas has been permanently certificated at a price higher than 17.0 cents. One proposed sale, Humble to Natural Gas Pipeline in Docket No. CI64-677 is at 17.0 cents, under a contract dated October 1, 1963. Giving due consideration to all sales in the area during the period in question, an in-line price of 17.0 cents is fully justified."

We submit that despite the Commission's language that the finding of the 17.0 cent price line "gives some weight to the unconditioned contract prices and the prices under temporary certificates," there is substan-

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[93] III R. 7294-5—Tabulation reproduced as Appendix D attached to this Brief.

tial evidence supporting the Commission's decision in *Hawkins, if only the permanently certificated* prices are considered. *Western Paper Makers' Chemical Company* v. *United States,* 271 U.S. 268, 271 (1926).

c. Temporarily-Certificated Sales

The Commission gave "some weight" to temporarily-certificated prices (III R. 7297), even though they were not regarded "as persuasive" (III R. 7295-96) as permanently-certificated prices, in determining the price line. Consideration of these prices was the primary reason for remand by the Court of Appeals which noted, however, that "recently, though, the FPC has attempted to make temporary certificates a more considered decision" (IV R. 4307).

It is clear that the Commission has the power, under this Court's decision in *F.P.C.* v. *Hunt,* 376 U.S. 515 (1964) to consider the initial price when it issues a *temporary,* as well as when it issues a *permanent,* certificate. It is apparent on this record that the Commission *did, in fact,* consider the price issue before issuing the temporary certificates which it gave "some weight" in determining the price line. Price reducing conditions, refund conditions, and moratoria against rate increase filings, were imposed in various temporary certificates. Where a price reducing condition was imposed, it was this *reduced* price which the Commission considered.

In *American Liberty Oil Co.* v. *F.P.C.*[94] the Fifth Circuit upheld the imposition of a price condition in a temporary certificate, even though there was no hearing or substantive findings, holding that the price con-

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[94] 301 F.2d 15 (5th Cir. 1962).

dition was subject to court review of its "reasonableness" and that in this case the Commission had acted within the bounds of its discretion.[95] Inclusion of temporarily-certificated prices in contracts for the 1958-1963 period resulted in a weighted average price of 18.05 cents (III R. 7296) which more than confirmed the Commission price line of 17 cents here in question.

d. The Effect of the Statement of General Policy

The Statement of General Policy No. 61-1, issued September 28, 1960, (24 FPC 818; 18 CFR § 2.56) has formed the keystone of the Commission's attempt to implement this Court's CATCO decision.[96] The Commission considered various factors set out in the Statement as follows (24 FPC 819):

> "In arriving at the price levels for the various areas set forth in the appendix to this statement, we have considered all of the relevant facts available to us. Such consideration included cost information from all decided and pending cases, existing and historical price structures, volumes of production, trends in production, price trends in the various areas over a number of years, trends in exploration and development, trends in demands, and the available markets for the gas."

In *F.P.C.* v. *Texaco Inc.*, 377 U.S. 33 (1964), this Court sustained the power of the Commission to prescribe "such regulations as it may find necessary as appropriate to carry out the provisions of this Act."[97]

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[95] *Id.*, at 18-19.

[96] This Court noted the Commission's efforts in this regard in *Second Phillips*, 373 U.S. 294, at pp. 307-08 (1963), and *Hunt*, 376 U.S. 515 at pp. 518, 527 (1964).

[97] 377 U.S. at 41 (1964).

The Commission's action in promulgating guideline prices under the Statement of General Policy, has received the approval of the District of Columbia Circuit,[98] the Tenth Circuit[99] and the Ninth Circuit[100] and by this Court in *Callery, supra.*

In convening each of the proceedings here under review, the Commission expressly stated that it would consider the effect of its Statement of General Policy upon contracts dated after that date.[101] The producers introduced evidence showing that they relied on the guideline prices set out in the Policy Statement and in many cases voluntarily reduced their contract prices in the hope of obtaining certificates without protracted proceedings (*e.g.,* III R. 226).

As the "guideline price" was established *ex parte,* and not through a contested hearing, it was not the establishment of an in-line price, but was still a factor to be considered in the determination of what the in-line price should be.[102]

After contested hearings were conducted on the in-line prices in each of the Texas Railroad Districts here in question, the Commission amended its guide-

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[98] Public Service Commission of New York v. F.P.C., 329 F.2d 242, 247 (D.C. Cir. 1964).

[99] Sohio Petroleum Co. v. F.P.C., 298 F.2d 465, 467 (10th Cir. 1961); Pan American Petroleum Corp. v. F.P.C., 298 F.2d 478 (10th Cir. 1961).

[100] California v. F.P.C., 353 F.2d 16, 22 (9th Cir. 1965).

[101] District No. 4, 28 FPC 412; District No. 3, 29 FPC 599; District No. 2, 30 FPC 1442-49.

[102] Sunray DX Oil Co. v. F.P.C., 370 F.2d 181 (10th Cir. 1966) [I R. 6714; citing Public Service Commission of New York v. F.P.C., 329 F.2d 242, 247 (D.C. Cir. 1964)].

line price in this area, reducing that price from 18 cents to 17 cents in Railroad District No. 3;[103] from 18 cents to 16 cents in Railroad District No. 4;[104] and from 18 cents to 16 cents in Railroad District No. 2.[105] The Commission concluded that it was following this Court's CATCO decision. The Commission stated:

> "* * * our guiding purpose here is to arrive at a revised price which will enable the Commission to hold the line on new sales in this area at a level consistent with the public interest and, at the same time, to enable producers to obtain authorizations which provide them a reasonable basis for proceeding with their operations and furnishing needed supplies of gas."[106]

In discussing the theory of "in-line" pricing regulation the Tenth Circuit said:[107]

> "The extensive study of the Commission taken before the issuance of Statement 61-1 negatives any aspect of arbitrariness."

Through its Statement of General Policy and the in-line decisions following it, the Commission has sought to establish reasonable price stability without a price freeze in this area pending the determination of a just and reasonable rate. The producers have cooperated by voluntarily reducing their initial contract prices to conform to the Commission's guidelines. The

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[103] Sixth Amendment, 29 FPC 590 (1963).

[104] Fifth Amendment, 28 FPC 441 (1962).

[105] Eighth Amendment, 30 FPC 1435 (1963).

[106] Sixth Amendment, 29 FPC 590 (1963).

[107] Sohio Petroleum Co. v. F.P.C., 298 F.2d 465, 467 (10th Cir. 1961).

Intervenors are seeking to "rollback" these prices to the depressed levels of the previous decade (I R. 5785). Thus, it was clearly within the Commission's discretion to give some weight to its Policy Statement prices, and to the industry's reliance thereon, and its action in so doing should not be disturbed.

2. The Evidence in the Sinclair Record Sustaining the 16-Cent Price Line for Post-Policy Statement Sales in District No. 4

The *Sinclair* record contains the same type of evidence discussed above in connection with the *Hawkins* case. In *Sinclair* the Examiner found that 83.36 per cent of the gas moving in interstate commerce from District No. 2, contracted for subsequent to the Policy Statement, was being sold at prices above the 16 cent level (IV R. 3917-18) made up of 1,933,983 Mcf under permanent certificates and 2,456,514 Mcf under temporarily certificated sales (IV R. 761,605; 696,315; 4176). The numerically weighted average price for this period was 16.68 cents per Mcf, and the volumetrically weighted average price was 17.18 cents per Mcf (IV R. 3918).

These percentages were arrived at by the exclusion of prices below 14 cents by the Examiner. The Commission found that the Examiner had erred in excluding these sales (except for the sales to Valley Gas Transmission Company). But even including the sales below 14 cents, the Commission found that still approximately 53 per cent of the estimated first month's volumes moved in interstate commerce in the price range of 16 cents to 18 cents (IV R. 4181). Recognizing that the temporary certificates covered most of the sales in the 16-18 cent range, the Commission fixed

the in-line price at 16 cents. With reference to its decision to consider the temporary certificates, the Commission said (IV R. 4180):

> "The permanently certificated prices reflect only a part of the market activity in the post-policy period. Permanent certification is granted only where the proposed price is within the applicable guideline price, and where there is no contest by any intervenors. Thus to limit the consideration to permanent certificates would permit a price freeze and would render the hearing in this proceeding be meaningless. The pre-policy price would automatically control because almost all contracts above 15.0 cents were contested."

The *Sinclair* record also contains evidence of the expanding intrastate market (IV R. 697-98) contrasted with a declining interstate market (IV R. 695-96).

IV. THE COURT OF APPEALS ERRED IN DECLARING THAT THE COMMISSION MUST DETERMINE PUBLIC AND PIPELINE NEED FOR GAS IN PRODUCER CERTIFICATE PROCEEDINGS

Although the Intervenors narrowly restricted the need issue to the possible effect upon the pipeline purchasers of take-or-pay provisions in producer contracts, the Court of Appeals held that questions of pipeline and public need must be determined in producer certificate cases. In so holding, the Court of Appeals not only exceeded the issue raised by the parties, but also substituted its judgment for that of the Commission as to the most appropriate prcoeeding for determining such need. In our view the Commission did not abuse its discretion in considering the question of public "need" for the gas in pipeline certificate proceedings, and considering the impact of take-or-pay provisions

in a separate rule-making proceeding.[108] Absent such an abuse of discretion, the Commission should have been affirmed.

At the pretrial conferences before the Commission where the issues to be litigated are defined,[109] counsel for Intervenors carefully limited the scope of the need issue which he was raising. Thus, he stated in the *Hawkins* case (III R. 56-57):

> "I think in the broadest gauge need would require a showing that it is needed by the consumers to whom this gas will ultimately flow. That is not what I had in mind. What I had in mind was a more limited showing of need, to wit: That the four purchasing pipelines here involved can take this gas without placing themselves in a take or pay situation, without aggravating an existing take or pay situation, and without cutting back on any lower priced gas in order to take it.
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> "In other words, the concept of need that I am insisting on here is not what I would call the very broad need matter, but solely a showing that the pipelines here have a need when measured against their take or pay obligations in their existing contracts."

In the *Sinclair* case, even this restricted need issue was not raised during the pretrial conference or at the hearing (IV R. 10-11, 17, 3701, 4185).

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[108] Docket No. R-199, Order No. 334, issued January 18, 1967, — FPC —, modified by Order No. 334-A, issued March 21, 1967, — FPC —. See Appendix F.

[109] See Section 1.18 of the Commission's Rules of Practice and Procedure, 18 CFR 1.18.

Notably, at no time was any question of waste of gas through inferior end-use by the pipelines' customers raised. Yet, the Court of Appeals held, *sua sponte* (IV R. 4297-4298):

> "One of the most important ways is to control and limit the end uses of gas. The FPC must compare various uses and determine which ones are more economically necessary. If the proposed sale is to a consumer who will use the gas in an economically 'inferior' way when the sale is not certificated. Of course, to do the job properly the FPC must consider *all* alternative uses. It recognizes this responsibility in pipeline certificate cases. But if it refuses to consider the issue in producer certificate cases and waits for pipeline cases, some of the alternatives will already have been eliminated. In the pipeline case the FPC can direct the gas towards one rather than another of the pipeline's customers but without considering the customers of other pipelines which might have bought the gas. Thus, the gas may go ultimately to consumers whose use will be less economically beneficial than the use of other potential purchasers.
>
> "Because the FPC refused to consider the issue of need, this record does not indicate whether or not this gas has been wasted. However, such wasting is a possible result of the alleged oversupply situation of some of the pipelines here. The possibility that gas may be wasted requires that the FPC determine the issue of need *before* the initial sale to a pipeline. Otherwise it may be too late to protect the public interest." [Footnotes omitted].

The lower court's holding contrasts with the Commission's practical determination of an immensely practical problem. Thus, in *Hawkins,* after noting that

the Intervenors had presented no evidence to support their contentions, the Commission held (III R. 7293):

> "We agree with the examiner that, because of the nature of the gas business and the obligation of pipeline companies to the consuming public, it is to be expected that such companies will occasionally have long-term contracts for supplies which will give them gas for future, even though the supplies may be slightly in excess of their present-day needs. The issue of public need should be confined to pipeline certificate proceedings, not producer applications."

In *Sinclair*, the Commission made clear the basis for its judgment that questions of public need should, more appropriately, have been raised in the pipeline certificate proceedings, declaring (IV R. 4185):

> "In many instances deliveries have been made under the contracts for several years. The New York Commission's evidence as to lack of need is not, in our judgment, persuasive. We find the exceptions of the New York Commission not appropriate in the present posture of this proceeding, particularly so, since such exceptions were raised after the certification of the pipeline purchasers had been authorized, and on the basis of a record which discloses no question as to need for the gas supply involved."

It is apparent that the Court of Appeals has substituted its judgment for the administrative discretion of the Commission to determine the manner in which it will dispose of its workload. The Commission, with its expert knowledge of the gas business and its own administrative expertise in processing pipeline and producer certificate proceedings, decided that the public and pipeline need issues, if any, should be determined

in the pipeline cases where those issues are directly relevant. The Commission's action was, of course, consonant with the broad scope afforded to administrative agencies to determine the manner and precedence in which they will process matters coming before them. *Cf., F.P.C.* v. *Tennessee Gas Transmission Co.,* 371 U.S. 145, 155 (1962); Section 16 of the Natural Gas Act, 15 U.S.C. 717o. For example, the Commission customarily exercises its power to consolidate numerous producer applications for hearing despite possible adverse impact upon individual applicants. In the exercise of its administrative discretion, the Commission even postpones action upon rate cases despite the requirement in Section 4(e) of the Act that the Commission shall give preference to hearing and decision of rate increase proceedings over other questions pending before it.[110] And this Court has recently upheld the Commission's refusal to admit evidence in producer certificate cases where the effect would be to protract unduly the length of the proceedings. *United Gas Improvement Co.* v. *Callery Properties, Inc., supra.*

Moreover, the Commission's decision to determine the issues of pipeline need and the need of the ultimate consumers, including conservation questions, in pipeline cases dovetails with the nature of the gas business. The Commission noted that pipeline companies will occasionally encounter scheduling problems in their purchase of supplies under long-term contracts (III R. 7293). Its expert evaluation of this problem and its decision to tackle the pipeline and public need issues in pipeline proceedings, while affording adequate protection through conditions in the producer certificates,

[110] Section 4(e), 15 U.S.C. § 717c(e).

contains the implicit recognition of the facts of life in pipeline operation.

Thus, ordinary business prudence requires a pipeline to schedule its purchases to meet the requirements of its customers, both in the short-run and for reasonable periods into the future. For market protection, the Commission normally requires that pipelines maintain a twelve-year deliverability life, that is, reserves must have sufficient deliverability to supply existing needs for at least twelve years.[111] In order to maintain reserves for protection of its markets, a pipeline may find it necessary to contract for the purchase of supplies greater than its immediate needs. This situation may arise, for example, when a particularly attractive gas reserve comes on the market. The pipeline must purchase the gas immediately or lose the entire reserve, and failure to add reserves as they become available inevitably would lead to a gas shortage for the pipelines' customers.[112]

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[111] See, Order No. 279, 31 FPC 750 (1964) where the Commission defined deliverability to represent:

> "* * * the number of future years during which a pipeline company can meet its annual requirements for its presently certificated delivery capacity from presently committed sources of supply. The availability of gas from these sources of supply shall be governed by the physical capabilities of these sources to deliver gas, by the terms of existing gas-purchase contracts and limitations imposed by state or federal regulatory agencies."

[112] F.P.C. v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1, at 17 (1961):

> "In this connection, it must be realized that the Commission's powers under § 7 are, by definition, limited. * * * The Commission cannot order a natural gas company to sell gas to users that it favors; it can only exercise a veto power over proposed transportation and it can only do this when a balance of *all* the circumstances weighs against certification."

Giving recognition to this aspect of the nature of the gas business, and also to the fact that producers cannot indefinitely postpone recoupment of their investments, gas sales contracts normally provide for deliveries over a twenty-year period. Customarily, these contracts also contain take-or-pay provisions, permitting the pipeline purchaser to postpone deliveries for periods ranging from a few years to the life of the contract. Payment is made currently based upon a formula which determines the average daily contract quantity to be purchased. The pipeline schedules its purchases from its numerous sources, correlating these purchases to its diverse market requirements. If this scheduling does not permit some gas to be taken during the time provided for in the gas sales contract, the pipeline prepays for the gas which it can take at a later date. The prepayments amount to compensation for storage of the gas in the field until the pipelines are ready to utilize the gas.

The Commission maintains continuous scrutiny over reserves and deliverability of gas available to pipelines through its report Form No. 15 which must be submitted annually by all pipeline companies.[113] Indicative of its recognition of the scheduling problems of pipeline purchases, the Commission held, when prescribing Form No. 15, that where a pipeline "has an active procurement program" and "its system extends into production areas with continuous exploration and the results thereof indicate a continuing ability to meet gas requirements," the twelve-year deliverability life requirement is relaxed.[114]

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[113] See, Section 260.7 of the Regulations under the Natural Gas Act, 18 CFR 260.7.

[114] Total Gas Supply of Pipeline Companies—Annual Report Form Order No. 279, 31 FPC 750-751 (1964).

When a pipeline seeks a certificate to add new supplies, the information obtained from annual reports is supplemented by the detailed data both as to gas supply and market demands (18 CFR 157.5-157.22). Among the information required of a pipeline is "Exhibit H—Total Gas Supply Data" which contains a statement of the total gas supply committed to, controlled by, or possessed by the applicant, including (1) estimated remaining recoverable reserves, (2) deliverability studies, (3) names and addresses of producers with whom applicant has gas purchase contracts together with the estimated reserves under each contract, (4) maps, and (5) conformed copies of each gas purchase contract upon which applicant relies in support of its proposal.

Additionally, a pipeline application must contain "Exhibit I—Market Data" which includes a system-wide estimate of volumes to be sold together with (1) names and locations of customers giving breakdowns among residential, commercial, firm industrial, interruptible industrial, residential space-heating, commercial space-heating, and other types of customers for each distribution system.

Importantly, the end-use of gas consumed by large direct industrial customers must also be specified.

It is thus obvious that the Commission has prescribed regulations which are tailored to enable it to consider and dispose of all aspects of the public and pipeline need issues in pipeline certificate proceedings. Commission opinions contain many examples of cases where the aspects of need, such as conservation of gas consumed for boiler-fuel purposes, have played a significant role in its decision. See, *e.g., F.P.C.* v. *Transcontinental Gas Pipe Line Corp.,* 365 U.S. 1 (1961);

Transwestern Pipeline Co., (the *Gulf Pacific* case), Opinion No. 500, 36 FPC 176 (1966), Opinion No. 500-A, 36 FPC 1010 (1966); *Florida Gas Transmission Co.*, Docket No. CP65-393, Opinion No. 516 issued March 1, 1967, and *Transcontinental Gas Pipe Line Corp.*, Docket No. CP65-181 (Phase II), Opinion No. 532, issued November 6, 1967.

Furthermore, the Commission was careful to condition each of the certificates issued to the producers in *Hawkins* and *Sinclair* upon the express condition that the allowance of the take-or-pay provisions in the applicant's contract would be subject to the Commission's ultimate disposition with respect to such provisions in the then pending rule-making proceeding in Docket No. R-199. In that proceeding, the Commission had under consideration the issuance of a rule which would limit provisions in producer rate schedules by prohibiting the use of certain daily contract quantity provisions and unduly short make-up provisions. After careful study and review of comments submitted by interested parties, the Commission, in its Order No. 334, issued January 18, 1967, amended its Regulations to provide for minimum make-up periods for prepaid gas of at least five years. Clearly, this action, which applies to all of the sales involved in these proceedings, amply protects the pipeline industry from the incurrence of substantial prepayment balances and from possible forfeiture or loss of the payments through inability to take the gas.[115]

Quite properly also, the Commission concluded that it is not part of a producer applicant's case to prove

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[115] For convenience of the Court, there is attached in Appendix F hereto, a copy of the Commission's Order No. 334 and its Clarifying Order No. 334-A.

the absence of pipeline take-or-pay problems. Of course, it was open to the Intervenors to present evidence, if they could, to show what effect any of these sales might have upon the respective pipeline purchaser's take-or-pay status. Significantly, however, Intervenors adduced no evidence of any kind. Instead, they rely principally upon their contention that they need only suggest the possibility of adverse take-or-pay effect to impose upon the applicants the burden of providing the absence of such effect. Reference to Commission orders in other proceedings which discuss the take-or-pay problem faced by some of the pipelines is no substitute for evidence in these proceedings directed to showing whether or not these particular sales have had any effect upon the respective pipelines take-or-pay positions.

Without conceding that they have a burden of proving the absence of an adverse take-or-pay effect of their sales upon the pipeline purchasers, the producer-applicants in *Hawkins* did adduce evidence which demonstrates that the sales involved in these proceedings did not require the pipeline purchasers to pay for gas which they could never take. Thus, the record shows that of the pipeline companies purchasing gas in the *Hawkins* case, Trunkline Gas Company and Natural Gas Pipe Line Company of America reported no prepayments for gas not taken (III R. 1338). Tennessee Gas Transmission Company reported relatively small prepayments based upon its total operations and there is no showing whatsoever that the prepayments are related to these sales. Likewise, Florida Gas Transmission Company had only a small prepayment sum as of the end of 1963 (III R. 1338-1339). Furthermore, prepayments made by United Gas Pipe Line Company and Transcontinental Gas Pipe Line Corporation,

which are involved in the *Sinclair* case, relate primarily to prepayments for South Louisiana gas, not for Texas Gulf Coast gas (III R. 1336-1337). In substituting its judgment for that of the Commission, the Court of Appeals overlooked the fact that when a producer makes an unrestricted sale to a pipeline, the gas merely becomes part of the pipeline's total system supply. That supply is consumed, ultimately, for a broad range of uses. Typically, some gas is sold to distribution companies for resale to domestic, commercial, and industrial customers. Some portion may be sold for boiler fuel used by electric generating companies, either by the pipelines directly or by the distribution companies.

However, it is not possible to determine where the gas of a particular producer-applicant will be consumed. Standard Commission practice forbids dedication of specific volumes or purchases of gas to specific customers. And the Commission has long held that specific gas supplies of a pipeline cannot be dedicated for specific markets. *Mississippi River Fuel Corp.* v. *F.P.C.*, 252 F.2d 619, 623-625 (D.C. Cir. 1957).

The concept of dedication of producer supplies for specified markets is antithetical to this Court's recent holding in *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366, 369-370 (1965). In that case, the Lo-Vaca proposal concerned a sale to a pipeline company which would have contractually restricted the use of the gas to prescribed points. The Court affirmed the Commission in holding that there could be no restricted sales to a pipeline where the gas was commingled with gen-

eral system supplies. Since some molecules of Lo-Vaca's gas might end up at points of sale for resale to ultimate consumers, Lo-Vaca's sale could not, the Court reasoned, be construed as a sale for the pipeline's own use.

By the same token, all the gas sold by the producers in these proceedings, forms a part of the pipeline purchasers' system supplies. It cannot be attributed to any particular use. Consequently, the lower court's requirement that, before certification of the producer sales, the end-use of the gas must be determined conflicts with controlling law enunciated by this Court.

Section 7(e) places the burden of proof upon the applicant to demonstrate that the public convenience and necessity requires the proposed sale. *Sunray Mid-Continent Oil Co.* v. *F.P.C.,* 364 U.S. 137 (1960); *Atlantic Refining Co.* v. *Public Service Commission of New York,* 360 U.S. 378 (1959). Perhaps in recognition of the fact that its novel theory would impose an impossible burden upon a producer applicant, the Court of Appeals held that the Commission must undertake the burden of proof on this issue.[116] Thus, it suggests that the Commission's Staff should make studies and thereafter the Commission should issue policy statements relevant to large geographic areas or even to the entire gas industry. It would be the Commission's duty, according to the lower court, to "show that the broad statement or study covers the particular certification before it." (IV R. 4301).

Presumably, the producer-applicant would remain responsible for his case as far as other aspects of the

[116] Obviously, for example, Mr. Stockard, an applicant in these consolidated proceedings, could have no way of showing how customers of his pipeline purchaser will use his gas. The same would be true of any producer-applicant.

public convenience and necessity are concerned. For example, the producer would have the burden of proving that his sales price is in line with other prices in the area. But for proof of the relative superiority of end use of his gas, the producer would be forced to rely upon unknown Staff studies and Commission policy statements. If the Commission or its Staff should, for whatever set of reasons, fail to support that burden, the application would fail. We submit that basic fairness requires that producer-applicants may not be made dependent upon a third party for an essential element of their case. In making the success of a producer application dependent upon proof which might be submitted by the Commission, the decision below violates Section 7(e) of the Act which places the burden of proof upon the applicant.

Finally, it must be recognized that the conservation, or the relative-superiority-of-use question, was raised by the lower court, *sua sponte*. Under the exclusive review procedure provided by Section 19(b) of the Act, a reviewing court may not, of its own accord, raise an issue which was not presented by the parties. *Sunray Mid-Continent Oil Co.* v. *F.P.C.*, 353 U.S. 944 (1957).

The lower court claims support for its broadening of the issues by reference to statements in the exceptions or applications for rehearing filed by the Intervenors. But careful analysis of the Intervenors' contentions shows that their reference to "public need" was in no way related to the relative-superiority-of-use theory raised by the Court of Appeals. On the contrary, it is quite clear both from the statement of counsel for the Intervenors (*supra*, p. 54) and from the context of Intervenors' arguments in their pleadings that reference was strictly limited to the question

of take-or-pay (See III R. 7114-7120; IV R. 4070-4071; 4244). This narrow issue which relates to whether the pipelines could schedule their purchases without being required to pay for gas which they could not take, is entirely different from the question raised by the Court of Appeals. Until issuance of the lower court's opinion, there had been no suggestion that consumers of any pipeline might be devoting their supplies to an "inferior" use. Since the issue was not raised by any party, Section 19(b) of the Natural Gas Act and Section 10(e) of the Administrative Procedure Act preclude *sua sponte* consideration of this issue by the Court of Appeals, *F.P.C.* v. *Colorado Interstate Gas Co.*, 348 U.S. 492, 498-499 (1955).

V. CONCLUSION

Through the promulgation of its Policy Statement, and the in-line pricing decisions in *Amerada,*[117] *Hawkins* and *Sinclair,* the Commission has "stabilized," but not frozen, the price line in the Texas Gulf Coast Area. The Commission has the power and the duty under the Natural Gas Act, affirmed by this Court in *Callery,* to reconsider and if necessary to change the price line in a Section 7 proceeding, if it finds such change to be in the public interest. The decision of the Court of Appeals would divest the Commission of this power and through the expedient of removing from the Commission's consideration all possible evidence which could change the line, irrevocably freeze the line at the level arbitrarily selected by the Intervenors without evidence or even explanation. The Commission did

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[117] Together with its later decision in Turnbull & Zoch Drilling Co., 34 FPC 1001, affirmed Continental Oil Company v. F.P.C., 378 F.2d 510 (5th Cir. 1967), also involving District No. 4.

not abuse its discretion and its actions are supported by substantial record evidence and have been affirmed in parallel cases by the Fifth, Ninth, and Tenth Circuits. The decision below of the Court of Appeals which is in conflict with these cases and which goes beyond the permissible bounds of judicial review of an administrative order, should be reversed.

In determining the question of the pipeline's "need" for gas in a pipeline certificate case rather than a producer certificate case, reinforced by a specific rule-making proceeding on the impact of take-or-pay provisions, the Commission properly exercised its expertise and arrived at the most practical solution to the question from the standpoint of producer, pipeline and consumer. The attempt of the Court of Appeals to substitute its judgment for that of the Commission on this issue should be overruled.

Respectfully submitted,

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